About 10 days ago, I wrote you all about the Housing Finance Reform Bill (H.R. 1859) that I have written and am sponsoring along with Gary Peters (D-MI). I mentioned in that missive that this is an important bill that will consume a great deal of my time and energy over the coming months. Based on the numerous responses from all of you, you seem to agree. I appreciate all those who responded offering your support and assistance in moving this bill forward. I will be separately contacting those of you who did soon.

Reading your responses last week, I noticed there were questions on this fairly complex issue that came up several times. So, I have decided to include the “most asked” questions into this edition and am answering them to give you an even better idea of what this bill is, how it works and why I wrote it:

1. John, isn't your bill just recreating the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac again? It looks like you are just going to have 5 of them instead of two.

No. The whole point of this bill is to kill the old GSE system and replace it with something completely different that will provide stability for housing finance. The GSEs were/are monopoly entities formed by the government. The "associations" in H.R. 1859 will be entirely private entities and there will be at least 5 of them, but we frankly hope there will be dozens in order to create competition and spread the risk around. The existing GSEs can make mortgages, hold them in their portfolios, sell them and engage in all kinds of other businesses. In my bill, associations can only guarantee conforming mortgages and they cannot make or hold any mortgages themselves. The GSE's themselves were guaranteed by the federal government for dollar one of loss. The associations will not have any federal guarantee. The only federal guarantee will be on the mortgages and not the associations, and it will only kick in after the down payment, all capital in the entity, and all capital in the insurance fund is gone. The GSEs pay nothing for their federal guarantee, but the associations will pay a market rate to put a guarantee on a group of mortgages. In short, the GSEs were their own special entity and there was and is nothing like them. The associations in my bill will follow the model of public utilities (your electric company, for example) and the banking system. Remember that when you make a deposit in a bank, it is guaranteed by the FDIC. But, the capital requirements, limits, insurance fund and number of banks out there have made the system work even through the recent crisis.

2. How is the taxpayer protected? How do I know there won't be another bail-out like the

current bail-out of the GSEs?

As I mentioned above, my system is very different than the GSEs. The fact that there will be many of these associations and that they are not themselves guaranteed by the government means that they can fail and, if they do, there will be no government money used to prop up the entities. In order for the taxpayers to be at risk, a group of mortgage portfolios would have to first decline enough to eat through the 20% down payment (more on that later). Then, the losses would have to eat through the entire substantial capital of the association, which would then have to be insolvent. If that occurs, the losses would still then have to eat through another layer of private capital, which is the insurance fund (again, similar to the FDIC) into which all of the associations pay. Even then, the government can ask the remaining associations to pay more into the insurance fund to top it up. Bottom line is that the amount of private capital and the control of these organizations will be such that a collapse like we had in 2008 would not trigger any taxpayer liability.

3. Why not let the GSEs wind down and then not replace them with anything? Why not rely on the private sector?

Throughout my lifetime, we have always had some government support for home mortgages. Without some support, the 30 year mortgage will go away. Investors will simply not make loans of that duration, with a fixed rate, and additionally take the 30 year risk that you might not ever pay them back. If we were to wind down the GSEs without some viable replacement system, home loans would likely require 25% down or more and mortgage durations would fall to 15 years or less. This would easily trigger a 30% decline in housing prices as the payments for any home loan would rise dramatically. This decline would plunge the economy into a major recession/depression and greatly reduce the number of people able to own homes in the future. This is a disaster scenario which is completely avoidable. The government is making over 95% of all home loans right now through the GSEs and FHA. That alone is proof that there is no viable private market for such loans or it would be developing now.

4. Will I have to put 20% down to buy a house? That's a lot more than many people can afford.

Yes and no. The federal government will only provide a guarantee for 80% or less of the value of the house at the time of the loan. That means you need 20% down. This protects the taxpayer. But, there is a provision in the bill to allow for a guarantee of 10% down only if the entity originating the loan either buys separate mortgage insurance on that 10% or the originator puts up that capital themselves. In other words, my bill allows 10% down if someone else other than the association or the government takes the risk on that 10%. Furthermore, remember that loans can be made without this guarantee. It is not mandatory. And, it costs money to get it. So, if some in the private sector want to make 5% or no-down loans they can absolutely do it. But, the taxpayer and these associations will have nothing to do with them.

5. Do investors really need a government guarantee? Isn't this preferential to them?

As I mentioned above, someone who makes a 30 year fixed rate loan is taking on a lot of risk. There is the risk that interest rates will go up and their investment will lose value. This is called rate risk. There's the risk that the market will go cold on these sorts of investments. This is market risk. There is the fact that they are loaning money for a long time and can't plan to be paid back in full for 30 years. That is duration risk. Then there is the risk that the house will drop dramatically in value and the borrower will default. That is called credit risk. The fact is that very few investors will take on all 4 of these risks at an interest rate that any borrower could pay or would be willing to pay. Would you? Would you loan money to me at 4% now for the next 30 years? No? Neither will anyone else. What the associations provide is the removal of the 4th risk (credit risk) from the equation for the end-user investor. With that risk insured by the new associations, investors are willing to accept the other risks. Then, money will flow into the market for homebuyers to borrow.

6. What about low income people? Do you provide special assistance for them in your bill?

No. By definition, the low-income borrower wants government backing because they are a significant credit risk. I understand that there are people who believe that the government should be subsidizing or otherwise assisting low income families into home ownership that they cannot afford under the structure with which all other such loans are made. I happen to disagree with those people. I believe that there is no shame in renting, and that we do nothing to help people by incentivizing them to buy something that they cannot afford. But, even if you believe as they do and not as I do, the place to do such a thing is FHA. The original purpose of FHA was to help low income people buy low priced housing. One of the causes of the housing bubble and its subsequent collapse was that we loaned money to people who could not afford to pay it back. Let's not pollute 95% of the market again with this small percentage of loans, and either eliminate social engineering or keep it separate and contained.

7. The housing market is still recovering. Doesn't an entirely new system jeopardize that recovery?

Quite the opposite actually. Everyone knows that the GSEs can't continue as they are presently. But, no one knows what will be next. That uncertainty hangs over the housing market right now and is part of what is holding it back. This bill removes that uncertainty and gives the marketplace the assurance that 30 year fixed rate mortgages will be available in the future on a stable and consistent basis. People will then feel confident re-investing in housing.